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SUBJECT: TURKEY AMENDMENTS MAY CURB INVESTOR APPETITE FOR  
TURKISH ELECTRICITY DISTRIBUTION NETWORK

Ref: Ankara 3223

Sensitive But Unclassified. Please handle accordingly.

1. (SBU) Summary: Long awaited Government of Turkey (GOT) amendments to the Electricity Market Law, aimed to set the guidelines for the upcoming sale of the Turkish electricity distribution network, were delayed to October. The GOT made a last-minute move to pass particular articles of this amendment before the recess, by including them in the separate Law Regulating Privatization Implementation. The GOT's unexpected granting of internal distribution rights to the organized industrial zones and calling for state ownership of new investments in the distribution network may give potential investors concern. End Summary.

2. (SBU) The draft amendment to the Electricity Market Law (Reftel), intended to clarify details for the electricity distribution network sale, was sent for Cabinet signature in June. However, the legislation did not move out of the Parliamentary commissions before the recess in July, so the amendment has been delayed to the next legislative period starting in October. The GOT unexpectedly attached some related amendments to the separate Law Regulating Privatization Implementations passed on July 2003. The GOT had withdrawn these articles from the original Electricity Market Law draft, given negative reaction from the Energy Market Regulatory Authority (EMRA) and the private sector. The newly passed amendments include the following:

-- Ownership of investments made to improve, strengthen, and expand electricity distribution facilities after privatization will belong to the government.

-- Investment plans and implementation, as well as the management of the electricity distribution facilities, will be subject to EMRA's approval and supervision.

-- Organized Industrial Zones (OSB) will have the right to generate, distribute and trade electricity in their own defined regions. (Note: In addition to promoting investment in certain regions, the GOT encourages investment in special production areas like the OSB's to ensure better standards in environmental protection, cultural preservation, and earthquake resistant construction. End Note.) The special companies established in OSB's to provide these services will treat the OSB members as independent consumers, and their sales price to these consumers cannot exceed the market rate. The Turkish Electricity Distribution Company (TEDAS) will transfer the ownership and operating rights of the distribution network in these areas to the OSBs.

-- Private distribution companies can establish generation facilities without any limitation, in addition to their distribution or retail activities. These companies can buy electricity from their own generation facilities, but cannot pay a higher rate than the prevailing market rate.

3. (SBU) EMRA Electricity Market Department Head Murat Erenel told Econoff and Econ Specialist on July 20 that EMRA was disappointed with the last-minute changes passed by the GOT. Erenel noted that the GOT had withdrawn the article on OSBs and the one enabling vertical integration earlier, but inserted both articles in the separate Law Regulating Privatization Implementations on July 3. Erenel criticized the generation, trading and distribution rights given to OSBs, which accounted for up to 70 percent of consumption in less developed areas. Erenel asserted that this change would reduce the chance of privatizing the distribution facilities in Eastern and Southeastern Turkey. The domestic industrial sector got what they wanted with this law, according to Erenel, at the potential cost of losing a successful privatization with higher revenue. Erenel had previously criticized the GOT's intention to lift the 20 percent limit on energy generation controlled by the distribution companies, on the grounds that giving the right to generate and distribute electricity to the same company

in a certain region would inhibit competition. In press accounts EMRA criticized the GOT's decision to retain ownership of investments after privatization, which EMRA believes will strengthen State electricity distribution company TEDAS' involvement in the sector as a landlord closely following the new investments made on its property.

14. (SBU) Econ Specialist contacted Dr. Fatih Hasdemir, the Privatization Administration (PA) Group Head for Electricity Distribution on July 28, to receive the PA's perspective on the recent developments. Dr. Hasdemir confirmed that the recent exclusion of OSB's from the distribution portfolio would negatively affect PA's revenue projections. Hasdemir noted that the new amendments in fact clarified previous ambiguities with respect to the distribution rights in the OSB legislation. Commenting on the unlimited trading rights given to distribution companies generating electricity in the same region, Hasdemir pointed out the "prevailing market rate" limitation, which he believed would prevent anti-competitive practices.

15. (SBU) Comment: In an effort to successfully and in a timely way conclude big privatizations in its portfolio, the GOT has been trying to prevent possible attacks that may come from privatization opponents. We believe the industrial zones' carve-out from the privatization portfolio and the ownership of the post-privatization investments remaining with the GOT may negatively affect investor interest. After these changes, investors are likely to focus their interest in the Turkish distribution network in the more developed, industrial areas in western Turkey. The GOT may end up keeping the eastern regions, which exhibit the highest investment needs. The eastern regions are perceived as less profitable, and carving out the OSB's will make them even less interesting to potential investors. We note that the future status of the distribution company TEDAS after privatization remains ambiguous. We have seen press reports that the GOT is seeking to reduce access to international arbitration which would be another negative factor for investors, especially in light of past flip-flops by the GOT with respect to BOT's and TOR's and the alphabet soup of tried and (often) failed models for seeking investment.

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